FINAL STATEMENT OF REASONS  
FOR THE ADOPTION OF RULES REGARDING PUBLIC BANKING  
PRO 01/120  

UPDATED INITIAL STATEMENT OF REASONS [Government Code Section 11346.9, Subdivision (a)(1)]

On October 2, 2019, the Governor signed into law AB 857 (Chapter 442, Statutes of 2019). AB 857 establishes a process for a local agency to apply for a bank charter. In the Initial Statement of Reasons for this rulemaking action, the Department of Financial Protection and Innovation (Department or Commissioner) highlighted the following objectives of this rulemaking: 1. to define or clarify terms related to public banking not defined in statute; and 2. to clarify factors in the Commissioner’s processing of applications for a public bank charter that need to be evaluated differently due to the unique organizational and business structure of a public bank.

By this rulemaking, the Commissioner proposes to amend Sections 10.112; 10.141; 10.151; 10.3000: 10.3100; 10.3402; and the title of Subarticle 2, Article 4; and to adopt Sections 10.131.7; 10.135.1; 10.140.1; 10.140.6; 10.141.1; 10.166.1; and 10.3301.1 in Chapter 1 of Title 10 of the California Code of Regulations. These regulations are necessary to implement and effectively administer new legislation authorizing public banks for the first time in California.

Many benefits are anticipated from this regulatory action. Public banks may offer local agency banking, infrastructure lending, participation lending, and wholesale lending. Local agencies may be able to invest their money and satisfy their banking needs at more advantageous rates, fees, terms and conditions. Local agencies may earn greater rates of return on their invested monies through participation and wholesale lending. California’s critical infrastructure needs and shortage, including the housing shortage, may be addressed and improved through infrastructure lending by public banks.

Improved infrastructure and additional housing will be safer and provide additional housing units to combat California’s severe housing crisis. This will benefit the physical, mental and emotional health and welfare of California residents, generally.

The final regulations meet the Department’s objectives. The Department has made some changes to the originally proposed rules. The Department modified the text in response to comments to ensure the regulations were consistent with bank operations and the realities of the marketplace and banking industry.

The final regulations strike a balance between supporting the benefits which may be realized by Californians and protecting against a public bank’s failure by ensuring that public bank applicants demonstrate the financial ability, stability and experience to ensure a likelihood of success.
March 5, 2021 Modifications to the Text

In the March 5, 2021 modifications to the proposed rules, the Department strove to make the rules further accord with the facts, marketplace and operational realities of banks, and to facilitate compliance. To facilitate these goals, the Department incorporated some changes requested by stakeholders.

ADDITIONAL CLARIFICATION OF NECESSITY FOR MODIFIED TEXT

The Department reiterates the necessity for each of the proposed rules included in its Initial Statement of Reasons published on December 4, 2020. The Department adds the following additional clarification of necessity for the proposed rules listed below, which were modified in the March 5, 2021 Modified Text.

- Rule 10.131.7. Financial Product or Service. It is necessary to clarify that the Commissioner expanded the factors upon which he will determine whether a financial product or service is offered by a local financial institution within the jurisdiction of the public bank. In addition to considering the type or category of product or service offered, the modified text identifies in detail the expanded factors which the Commissioner will consider. The amendment is necessary to align the rule with marketplace realities. The modified rule recognizes that while a product may be similar in category type (e.g., checking account), it can be completely different based on its features and benefits, such as fees. This amendment is necessary because it allows the public bank to demonstrate that the product it would like to offer its target market is, in reality and actuality, completely different than the product within the same category offered by local financial institutions within the public bank’s jurisdiction.

- Rule 10.140.6. Local Financial Institution. The proposed amendment is necessary to clarify that a local financial institution must have a physical presence within the jurisdiction of a public bank, defined to mean at least one branch within the public bank’s jurisdiction. Physical presence does not include ancillary facilities such as automated teller machine(s), loan production office(s), or offices performing corporate, administrative or back-office functions. This amendment is necessary to set a reasonable, industry standard by which a local financial institution can be realistically considered a local financial institution vested in and serving the local community.

- Rule 10.3402. Exemptions. The proposed amendment deletes as unnecessary Section 10.3402, subdivision (c). The law authorizing public banking and the current regulations and law applicable to banks provide a structure and requirements to protect pre-opening public funds. Commissioner preapproval
would unnecessarily delay the processing and progression of public bank applications.

This amendment is necessary to eliminate putting public bank applicants at a disadvantage to private bank applicants.

LOCAL MANDATE DETERMINATION [Government Code Section 11346.9, Subdivision (a)(2)]

The Commissioner has determined that the adoption of these regulations does not impose a mandate on local agencies or school districts.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE INITIAL NOTICE PERIOD OF DECEMBER 4, 2020 THROUGH JANUARY 21, 2021. [Government Code Section 11346.9, Subdivision (a)(3)]

The Department received four public comment letters during the 45-day public comment period. The comments are summarized below, together with the Department’s response.

1. Commenter: Letter dated January 21, 2021 from Sylvia Chi, Esq., Policy Director, Asian Pacific Environmental Network, for the California Public Banking Alliance (CPBA). CPBA commented on specific rules, listed below. The Department’s response follows each comment.

Comment No.1: Rule 10.131.7, Financial Product or Service.

CPBA asserts that the definition of financial product or service “should distinguish products or services based on terms and features and incorporate a materiality provision to reflect whether the product or service actually implicates competition in the area.”

CPBA notes that public banks may only conduct “retail activities” (defined in the law as “providing any kind of financial product or service to a person that is typically offered or provided by a local financial institution”) in partnership with a local financial institution unless the retail activity is not offered by local financial institutions in the jurisdiction of the local agency or agencies that own the public bank.

CPBA comments that determining that products are the same based on being in the same generic category type (e.g., checking account) does not reflect the reality that products in the same category type can be vastly different based on each product’s features and benefits, notably monthly account fees and overdraft fees. Each product must be viewed individually to conclude whether the product is offered by a local financial institution. Doing so will help achieve the legislative goal.
Response: The Department agrees with CPBA’s comment and revised the Rule in the modified text to accommodate these comments.

Comment No. 2: Rule 10.140.6, Local Financial Institution.
CPBA asserts that “local financial institution” should be defined with additional factors beyond mere physical presence in the local agency’s jurisdiction to better reflect the factors relevant to the competitive environment. CPBA cites as additional factors the number of loans provided, deposits received, and other business conducted in the area. A local financial institution should not be considered to maintain a “physical presence” in an area if it merely provides an ATM, loan production office (LPO), or a branch office offering only limited services.

Response: The Department agrees in part and disagrees in part. The Department agrees that an ATM, LPO or corporate or administrative offices should not constitute a “physical presence” in the local agency’s jurisdiction. The Department modified the text to specify that physical presence does not include such ancillary facilities but means one or more branch offices. Having one or more branch offices demonstrates investment in the local community and that the financial institution can be considered a true competitor to a public bank.

The Department disagrees that factors such as number of loans provided or deposits received by a local financial institution should be considered in determining whether there is a “physical presence.” These factors are more difficult to quantify and would impose an unnecessary regulatory burden on the Department and the public bank. Defining physical presence to mean one or more branches is a straightforward, reasonable way to determine whether an institution is a local financial institution.

Comment No. 3: Rule 10.3301.1, Reasonable Promise of Successful Operation.
CPBA asserts that “the administrative standard for evaluating a public bank applicant’s “reasonable promise of success” must account for any social or environmental goals identified in the applicant’s viability study and business plan, in addition to the applicant’s financial goals and projections.”

Response: The Department disagrees. The applicant can include social or environmental goals in the viability study it must submit to the local agency for approval to apply. Public bank licensees can also adhere to such goals by including them in their investment policies. The Department’s insistence that public bank applicants meet the same financial requirements as private bank applicants will give public bank licensees the best chance of achieving long-term existence and success, which will also protect the FDIC insurance fund since public banks will be FDIC-insured. If the Department relaxed these longstanding financial requirements which all banking applicants must meet, the safety, soundness and long-term success of public banks, and protection of public money, would be jeopardized.
Comment No. 4: Rule 10.3402, Exemptions.
The CPBA argues that eliminating the specified exemption from Commissioner pre-
approval to solicit pre-opening funds is unnecessary and “puts public bank organizers at
a distinct practical disadvantage relative to private sector bank organizers by creating a
new requirement for Commissioner approval which was not imposed by the Legislature
and restricts the autonomy of local agency officials.”

Response: The Department agrees. The Department removed the exclusion from
exemption applicable to public banks in the modified text.

2. Commenter: Letter dated January 21, 2021 from Henry C. Levy, CPA, CFE,
Treasurer-Tax Collector, Alameda County.

Comment No.1: Mr. Levy asks whether a local agency could join with another local
agency and apply for a public bank charter without becoming a member or stockholder
and being required to make a cash contribution to the proposed public bank.

Response: The Department believes that the law is clear that a local agency may join
with another local agency to apply for a public bank charter. The law does not mandate
a cash contribution by the local agency wishing to join with the local agency which is
applying for a public bank license. The Department does not believe that any edits to
the proposed rules are necessary or appropriate.

3. Commenter: Email dated December 5, 2021 from George Uberti, Public Advocate.

Comment: Rule 10.135.1, Governing Board.
Mr. Uberti argues that governing board should not be defined as the bank’s board of
directors (Board), as Board meetings of private banks are confidential. Mr. Uberti
argues that public bank Board meetings should be open to the public under
“transparency laws relating to public records and public meetings, specifically the
California Public Records Act and the Brown Act.” Mr. Uberti asserts that these open
government laws should apply to “meetings of the board of directors…relating to loan or
investment decisions, to meetings with banking regulators, and to meetings of the
internal audit committee, [and] the compliance committee.”

Response: The Department disagrees. The public may participate in all local agency
meetings at which the viability study is presented and approval is sought to apply for a
public bank application. However, AB 857 expressly imposes a limitation on the public’s
right of access to the meetings of public bodies or the writings of public officials and
agencies within the meaning of Section 3 of Article I of the California Constitution. ¹

Government Code section 54956.97 specifically authorizes the governing board, or a
committee of the governing board, to meet in closed session on matters pertaining to
loan or investment decisions, decisions of the internal audit committee, the compliance

¹ AB 857 (Stats. 2019, Ch. 442), §§ 8, 9, 14 and 15, codified at Gov. Code, §§, 6254.26, 6254.35,
54956.97 and 54956.98, respectively.
committee and the governance committees, and meetings with a state or federal regulator. Information received in closed sessions may also be kept confidential.\(^2\) Therefore, the California Public Records Act and Brown Act cannot be applied to all of the governing board’s meetings.

The Legislature found that “[t]his bill balances the interests of a public bank in keeping certain important information confidential with the interest of the public in accessing information concerning the conduct of the people’s business.”\(^3\) The Legislature found further that “[c]ertain information collected by a public bank must be kept confidential because confidentiality is essential to a public bank’s relationships with its customers, lenders, regulators, and other banks. This confidentiality extends to portions of meetings of the board of directors relating to loan or investment decisions, to meetings with banking regulators, and to meetings of the internal audit committee, the compliance committee, or the governance committee of a public bank. This bill balances the interests of a public bank in keeping certain important information confidential with the interest of the public in accessing information concerning the conduct of the people’s business by allowing the public to monitor the performance of a public bank and allowing the public to know the identities of principals involved in management of a public bank so that conflicts of interest on the part of public officials can be avoided.”\(^4\)

4. **Commenter:** Email dated January 20, 2021 from Brett Garrett.

**Comment No.1:** Rule 10.3301.1. Reasonable Promise of Successful Operation. Mr. Garrett asserts that financial viability should not be the only criterion for determining the likelihood of success for a public bank. Mr. Garrett argues that “DFPI should accept any reasonable definition [of successful operation] that has been vetted and agreed by the agency’s elected officials.”

**Response:** The Department disagrees for the reasons stated in the Department’s Response to Comment No. 3 of Commenter No. 1, the CPBA. The Department adds that the Department has the expertise to determine the likelihood of successful operation due to its decades of experience processing applications for new bank charters. Due to this experience, the Legislature tasked the Department with reviewing applications for a public bank license and determining whether the application should be approved. Turning this responsibility over to each individual agency’s elected officials contravenes the law and will not serve the Department’s mandate of ensuring the safety and soundness of the bank.

**SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD OF MARCH 5, 2021 THROUGH MARCH 26, 2021 [Government Code Section 11346.9, Subdivision (a)(3)]**

\(^2\) Gov. Code, § 54956.98, subd. (b)(1).
\(^3\) AB 857 (Stats. 2019, Ch. 442), § 19.
\(^4\) AB 857 (Stats. 2019, Ch. 442), § 18.
The Department received three comments during the 15-day public comment period from March 5, 2021 through March 26, 2021. The comments are summarized below, together with the Department’s response.

1. Commenter: Letter dated March 8, 2021 from Angela L. Jeffers, SVP, General Counsel of Patelco Credit Union, Dublin, CA (Patelco).

Comment No. 1: While Patelco comments on two specific rules (see below), Patelco’s primary comment objects to the policy of authorizing public banks. Patelco asserts that the competition for business in the financial institution and services industry is intense. Patelco concludes its comment letter by stating that the text of the modified rules “do not address the significant negative impact Public Banks would have on credit unions and does not take into consideration the populations that can be served by credit unions in California communities. AB 857 would introduce another financial institution in an already heavily saturated market, therefore, Patelco respectfully requests that AB 857 not be approved.”

Response: The Department is not required to respond to general policy comments. The Department notes, however, that Patelco’s comments misunderstand that AB 857 is not a pending bill but was enacted into law, effective January 1, 2020. Patelco’s objection to the law and policy authorizing public banks are misdirected. They must be addressed to the Legislature.

Comment No. 2: Rule 10.131.7. Financial Product or Service.
Patelco states that the changes to the definition of Financial Product or Service in the modified text “do not specify that the public bank will be denied the ability to offer products or services in that jurisdiction if there is already a financial institution within the jurisdiction offering the same or similar product or service.”

Response: The Department disagrees. The law authorizing public banks already expressly requires that a public bank must “conduct retail activities in partnership with local financial institutions and shall not compete with local financial institutions,”5 unless “those retail activities are not offered or provided by local financial institutions in the jurisdiction of the local agency or agencies that own the public bank.”6 The law is clear. No further modification to the related rule is necessary or appropriate.

Comment No. 3: Rule 10.140.6. Local Financial Institution.
Patelco argues that “physical presence” should not determine whether an institution is a local financial institution, in light of the surge in digital, mobile banking.

Response: The Department disagrees. Defining a local financial institution by customers using an institution’s digital banking capacity within the local agency’s geographic area

5 Gov. Code, § 57604, subsection (b).
is nebulous and would result in many financial institutions being considered competitors of the public bank even when they are not located in or near the jurisdiction. This would impose an unjustifiable regulatory burden on a public bank resulting in its inability to offer any retail products, contrary to the law and its goals.

2. **Commenter:** Email dated March 17, 2021 from Michael T. Pines.

**Comment:** Mr. Pines did not make any specific comments. Mr. Pines submitted a general comment, noting that he “strongly support[ed AB 857.]”

**Response:** The Department is not required to respond to this general comment of support.


**Comment No. 1:** Rule 10.131.7. Financial Product or Service.
CPBA asks that the rule be further modified to state that a request to offer a product or service be supported by “publicly available” information and require the Commissioner to provide the basis for a denial of a public bank’s request to offer financial products or services within 15 days and allow the public bank the opportunity to amend its request.

**Response:** The Department disagrees. The Department modified the original rule to give public banks an opportunity to demonstrate that a product or service is not offered by a local financial institution. It is implicit in the modified rule that a public bank can only provide publicly available information, since it would not have access to confidential information. Further, the modified rule already authorizes a public bank to offer the proposed product or service if the Commissioner does not respond within 30 days of having received the required documentation and information. The bank is responsible for ensuring that it conducts thorough due diligence and submits all available information and documentation to support its request upon submission. As an experienced regulator whose mission is consumer protection, the Department will follow its standard procedure of reviewing the submission and asking any follow up questions or requesting any additional information or documentation regarding the request within the thirty days specified for Commissioner review. Modifying the text further to provide the bank an additional 15 days to respond to a denial is unnecessary and creates unnecessary work for the Department.

**Comment No. 2:** Rule 10.140.6. Local Financial Institution.
CPBA asks that “physical presence” be further modified to mean “one or more deposit-taking branch offices.” CPBA asserts that the addition of “deposit-taking” would affirmatively describe what qualifies as a physical presence.

**Response:** The Department disagrees.
“Physical presence” necessarily refers to a tangible or concrete location or site. In the context of bank offices, physical presence means a brick and mortar location. For example, the Banking Law defines the term “redesignate offices” to mean “the relocation by a bank of its head office to the site of a branch or facility office . . . or the relocation . . . of a branch office to the site of a facility office.” Consistent with the concept of “physical presence” meaning a tangible site, the proposed rule specifies that “physical presence” means one or more branch offices.

Which activities are performed at a branch office has no bearing on whether an office constitutes a “physical presence.” A branch office is a physical location. A branch is a building. A building/physical location is synonymous with physical presence. Therefore, to narrow the definition of physical presence to include only branch offices that take deposits, as suggested by the comment, would be inconsistent with the common understanding of what it means to have a physical presence.

Moreover, the law permits a public bank to engage in “retail activities” without partnering with a local financial institution, if those retail activities are not offered or provided by local financial institutions in the same jurisdiction as the public bank. “Retail activities” are defined to include accepting a deposit or granting a loan.

In defining “physical presence,” the proposed rule employs the term “branch office” because it is a defined term that includes the activities of accepting deposits and granting loans. In other words, the term “branch office” is a physical office that conducts “retail activities.” Specifically, the Banking Law defines a branch office as “any office at which core banking business is conducted . . . .” “Core banking business” is defined and includes, but is not limited to, “the business of receiving deposits” and making loans.

Given the detailed definition of branch office in law, and the fact that a branch office constitutes a physical presence within an area, no additional modification is necessary or appropriate.

ALTERNATIVES THAT WOULD LESSEN THE ADVERSE ECONOMIC IMPACT ON SMALL BUSINESSES [Government Code Section 11346.9, Subdivision (a)(5)]

Local agencies, which will be the public bank applicants, are not small businesses under Government Code section 11342.610. Therefore, no alternatives would lessen the impact of the proposed regulations on small businesses.

ALTERNATIVES DETERMINATION [Government Code Section 11346.9, Subdivision (a)(4)]

7 Fin. Code, § 1070, subd. (h) (emphasis added).
8 Gov. Code, § 67604, subd. (c)(2).
9 Gov. Code, § 67604, subd. (a)(6).
10 Fin. Code, § 1070, subd. (b).
11 Fin. Code, § 1070, subd. (c).
The Department has determined that no alternative it considered or that was otherwise identified and brought to its attention would be more effective in carrying out the purposes for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

The regulations adopted by the Department are to clarify terms and application processing factors necessary to implement the recently enacted law authorizing public banks. This legislation authorizes public banking for the first time in California. The proposed regulations are the only provisions that clarify terms and factors for prospective applicants and ensure the Department will maintain prudential oversight of public bank licensees. Except as set forth and discussed in the summary and responses to comments, no other alternative has been proposed or otherwise brought to the Department’s attention that is equally effective.

UPDATED INFORMATIVE DIGEST [Government Code Section 11346.9, Subdivision (b)]

The Department has updated the original informative digest, which was published in the Notice of Rulemaking Action in the December 4, 2020 California Regulatory Notice Register (Register 2020, No. 49-Z, No. Z-2020-1120-02), as follows:

- The Department revised the text once to meet the objectives specified in the original informative digest. The revisions incorporated into the final rules are to align with marketplace and operational realities, and to balance regulatory burden on local agencies with necessary protections for California’s banking system and economy.

- The revised text includes the following substantive changes:
  
  o Rule 10.131.7, Financial Product or Service: amends the definition to allow public banks to demonstrate that a product or service is not offered by a local financial institution due to distinguishing features (such as no monthly account or overdraft fees), despite being in the same general category type, e.g., a checking account.
  
  o Rule 10.140.6, Local Financial Institution: amends the definition to require a physical presence within the public bank’s jurisdiction. Specifies that physical presence includes one or more branches but does not include ancillary operations facilities such as administrative offices, loan production offices or ATMs.
  
  o Rule 10.3402: Exemptions: Deletes the exclusion from the exemption from Commissioner approval to pay pre-opening expenses.
FORMS INCORPORATED BY REFERENCE (Cal. Code Regs., tit. 1, § 20)

None.